No. 84-1119

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IN THE

Supreme Court of the United States

October Term, 1984

STUART C. GOLDBERG,

Petitioner,

against

SITOMER, SITOMER & PORGES, ALVIN LESTER SITOMER, STEPHEN JOEL SITOMER, JACOB ASCHKENASY, EMPIRE FIRE AND MARINE INSURANCE COMPANY, GARY O. GROSS and YALE J. KAPLAN,

Respondents,

and

ROBERT PORGES,

Defendant.

PETITION FOR A WRIT OF CERTIORARI TO THE NEW YORK COURT OF APPEALS

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Questions Presented for Review

Can a corrupt client in furtherance of its fraudulent activities silence its lawyer, by means of an injunction obtained by it from a federal court, and then prevent the lawyer from claiming a tolling of the statute of limitations during the period the injunction was in effect?

Did the determination below of the New York Court of Appeals fail to accord proper recognition to the force and effect of an order of a United States District Court (which enjoined petitioner, a lawyer, from disclosing confidential information regarding his former client's -- respondent Empire Fire and Marine Insurance Company's -- violations of the federal

securities laws) by refusing to recognize the District Court's order as effectively staying petitioner's assertion of claims against respondents, and thus as tolling the statute of limitations?

Will the determination below of the New York Court of Appeals have an adverse impact on the enforcement of the federal securities laws, through a chilling effect on lawyers who, upon discovery of a client's ongoing securities fraud, fulfill their ethical obligations, decline to participate in the fraud or its cover-up, and report such activities to the appropriate federal authority?

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Petitioner, Stuart C. Goldberg, respectfully requests that a writ of certiorari issue to review the judgment of the New York Court of Appeals dated October 11, 1984.

Opinions Below

On October 28, 1981, the Supreme Court of the State of New York, New York County, denied respondents' motions to dismiss petitioner's complaint, and on April 8, 1983, adhered to its decision on reargument. Its opinions are not reported, and appear in the Appendix, at 1a and 24a, respectively. The Appellate Division of the Supreme Court, on November 29, 1983, reversed, and dismissed the complaint. Its decision is reported, officially at 97 A.D. 2d 114, and unofficially at 469 N.Y.S. 2d 81, and appears in the Appendix at 27a. The Court of Appeals, on October 11, 1984, affirmed. The Court of Appeals' memorandum, affirming "for reasons stated in the opinion by Justice Samuel J.

Silverman at the Appellate Division," is not yet reported, and appears in the Appendix at 34a.

Grounds of Jurisdiction

The judgment of the New York Court of Appeals, review of which is sought, is dated, and was entered on, October 11, 1984. This Court has jurisdiction under 28 U.S.C. §1257(3), in that petitioner claims, but has been denied, a title, right, privilege and immunity under authority exercised under the United States.

Statutes Involved

United States Constitution, Art. VI, Cl. 2

> This Constitution, and the Laws of the United States which shall be made in Pursuance thereof; and all Treaties made, or which

shall be made, under the Authority of the United States, shall be the supreme Law of the Land; and the Judges in every State shall be bound thereby, any Thing in the Constitution or Laws of any State to the Contrary notwithstanding.

18 U.S.C. §401

A court of the United States shall have power to punish by fine or imprisonment, at its discretion, such contempt of its authority, and none other, as--

(1) Misbehavior of any person in its presence or so near thereto as to obstruct the administration of justice;

(2) Misbehavior of any of its officers in their official transactions;

(3) Disobedience or resistance to its lawful writ, process, order, rule, decree, or command.

New York Civil Practice Law and Rules §204(a)

Stay. Where the commencement of an action has been stayed by a court or by statutory prohibition, the duration of the stay is not a part of the time within which the action must be commenced.

Statement of the Case

Introduction and Summary

This case arose because petitioner, a lawyer, reported to the United States Securities and Exchange Commission a multi-million dollar securities fraud perpetrated by his law firm employers and a client of the firm. For a year and a half thereafter respondents subjected petitioner to a relentless campaign to impugn his integrity and silence him: until, what he had done was vindicated by a unanimous decision of the United States Court of Appeals for the Second Circuit -- a landmark case which a generation of young lawyers will study as a guide to how they should behave.

But now, the New York Court of Appeals has dismissed, as barred by a

one year limitation period, petitioner's claims against respondents for redress for the damage their campaign against him caused, even though petitioner was prevented from asserting those claims by an injunction of a United States District Court prohibiting him from disclosing any confidential information regarding the client. The narrower issue presented by the present petition is whether the New York Court of Appeals was free to disregard the District Court injunction as it did in applying New York's tolling statute. The broader and very far-reaching issue is the effect the decision below, denying petitioner even a day in court against admitted wrongdoers, will have on lawyers who in the future find themselves in the trying position of having to behave

ethically in the face of vigorous opposition from not only the client, but from fellow, and senior, members of the bar.

In January of 1973, petitioner, a young associate in a law firm (respondent Sitomer, Sitomer & Porges), discovered that the partners in the firm, in collusion with a client (respondent Empire Fire and Marine Insurance Company ["Empire"]), had perpetrated a deliberate multi-million dollar securities fraud. He urged upon the partners of the firm their duty to report what they had done to the Securities and Exchange Commission, but they refused. Petitioner, in turn, declined the invitation to become a part of his employers' cover-up, resigned from the firm and himself reported the fraud to the Commission.

As ultimate results of petitioner's disclosures (i) all of the partners of the Sitomer firm were suspended from practice before the Securities and Exchange Commission, (ii) the law firm and client participants in the fraud were enjoined from further violations of the federal securities laws, and (iii) the Sitomer firm and Empire paid more than $800,000 to a fund for the benefit of Empire's defrauded stockholders.

During the year and a half following petitioner's disclosures to the Securities and Exchange Commission, however, respondents engaged in a vicious campaign not only to continue to conceal their wrongdoing, but to destroy petitioner. It was <u>he</u>, not they, respondents tried to make it

appear, who had done wrong. Thus, they falsely told the Securities and Exchange Commission that petitioner had been the architect of the fraud. They filed false charges before the Grievance Committee of the New York City Bar Association, seeking petitioner's disbarment. Once the public stockholders of Empire had been made aware of the fraud perpetrated on them and a class action seeking redress had been commenced, Empire brought petitioner into that litigation, alleging that he had been guilty of malpractice and seeking judgment over against him in an amount computable at over $4 million. On top of all this, respondents had first obtained an order from the United States District Court for the Southern District of New York (in which the class action was pending)

which not only enjoined petitioner from "disclosing confidential information regarding Empire to others except to comply with rulings of the court on discovery proceedings or upon trial," but did so on findings -- urged on the Court by respondents -- that petitioner had violated his ethical obligations as a lawyer.

The impact of these events upon petitioner was, as might be expected, enormous. He had been compelled to resign from the employ of the Sitomer firm, and was unable to find employment for more than seven months. He was terminated as a front page securities law columnist by the New York Law Journal. He was subjected to investigation by the Securities and Exchange

Commission and the New York City Bar Association. He was publicly vilified as both a participant in respondents' securities fraud, and as an unethical lawyer.

It was not until June of 1974, when the decision of the United States Court of Appeals for the Second Circuit, on the appeal from the District Court decision, came down, that what petitioner had done was publicly, and fully, justified. While the Court of Appeals left standing the injunction against disclosure of confidential information regarding Empire, it made it eminently clear that petitioner in fact had done nothing unethical at all.

Petitioner has asserted against respondents claims to recover the

damages they caused him personally by involving him as an unknowing and innocent participant in their conspiracy and by their campaign against him. Those claims have been dismissed below as barred by limitations because not brought by January of 1974, within one year of petitioner's first discovery of respondents' securities fraud. In so applying the limitations period, the New York Court of Appeals necessarily ignored, not merely the tremendous burden and pressure petitioner was still under in January of 1974 (the United States Court of Appeals decision had not yet come down), all solely as a result of respondents' wrongs, but also that petitioner could not have filed his claims in January of 1974, being prevented from doing so

by the District Court injunction, obtained by respondents, which enjoined him from disclosing the confidential information regarding Empire that any statement of his claims must necessarily disclose.

The Facts

Petitioner was employed as an associate by the respondent law firm (in which the individual respondents Alvin and Stephen Sitomer and the individual defendant Robert Porges were partners) in November of 1971. Prior to his employment, the Sitomer firm had been retained by Empire in connection with a proposed public offering of stock. The Sitomer firm entered into a finder's arrangement with Empire pursuant to which it was to receive compensation contingent upon the results of the offering. But Empire's registration statement and prospectus, dated in March and May of 1972, respectively, did not disclose the finder's arrangement, as was required under the Securities Act of 1933.

Petitioner was, of course, aware that the firm was working on a public offering for Empire, and performed some work in connection with it, although another lawyer (respondent Ashkenasy) was in charge of preparing it. But he became aware of the existence of the Sitomer-Empire finder's arrangement only in January of 1973, long after the effective date (on or about May 31, 1972) of the registration statement.

Petitioner's discovery of the existence of the finder's arrangement arose out of another public offering as to which the Sitomer firm was representing the issuer. On Thursday, January 18, 1973, the underwriter of this second offering and the underwriter's counsel confronted the Sitomer firm

with the fact that a finder's agreement with the Sitomer firm, undisclosed in the registration statement due to become effective the following week, had been discovered.

When the existence of this finder's agreement was revealed, petitioner realized that the Sitomer firm's earlier representations to him, to the effect that the fee to be received in connection with the Empire registration was simply a fee for legal work for preparatory services and for the registration statement, might well have been false, and that the money might, rather, represent another finder's arrangement. On Saturday, January 20, 1973, the Sitomer firm, confronted with the results of a hasty investigation and persistent question-

ing, finally admitted to petitioner that such was the case, and he told the Sitomer firm that disclosure must be made to the S.E.C. When they refused, and their efforts to dissuade him from such disclosure proved unsuccessful, petitioner advised them that he, for one, would report to the S.E.C. on Monday morning, January 22, 1973, when indeed he voluntarily appeared before its Division of Enforcement, after he first, on January 21, 1973, resigned from the employ of the Sitomer firm. (It was on January 22, 1973, according to the determination below, that the statutory limitation period began to run [App. 31a]).

The S.E.C. now being aware of the concealments in the Empire registration statement, Empire was compelled

to disclose, in its Annual Report dated March 30, 1973 and S.E.C. Form 10-K dated March 31, 1973, the finder's arrangement and the fraudulent nature of the earlier registration statement and prospectus.

On May 2, 1973, an action was filed in the United States District Court for the Southern District of New York by two stockholders of Empire, alleging violations of the Securities Act of 1933 and the Securities Exchange Act of 1934, as well as certain common law causes of action, against Empire, officers and directors of Empire (including respondents Gross and Kaplan), the Sitomer firm and its three partners, the managing underwriter -- and petitioner. Meyerhofer v. Empire Fire and Marine Insurance Company (73 Civil 1940 LFM).

When he became aware that the Meyerhofer action had been filed, petitioner (before any service upon him) ascertained the substance of the complaint -- failure to disclose the finder's arrangement in Empire's registration statement and prospectus -- from counsel who had filed it, the firm of Bernson, Hoeniger, Freitag & Abbey. He then met with such counsel in an effort to demonstrate his unawareness at the time of the registration statement and prospectus of the finder's fee arrangement, that it had indeed been concealed from him, and that it was in point of fact he who had first brought the fraud to the attention of the S.E.C. In support of his position, and after consultation with his own counsel and the S.E.C.,

he made available to the Bernson firm a copy of an affidavit which he had previously supplied to the S.E.C. detailing the circumstances of his discovery of the Sitomer-Empire arrangement. The Bernson firm was, quite properly, satisfied with petitioner's explanation, and the District Court, upon their motion, permitted him to be dropped as a defendant in an order entered on June 15, 1973.

In the meantime, however, respondent Empire and its officers and directors (including respondents Gross and Kaplan) had applied to the District Court on June 7, 1973 for an order, under Canons 4 and 9 of the Code of Professional Responsibility and the supervisory power of the District Court, disqualifying the Bernson firm

because of its discussions with petitioner, and enjoining the Bernson firm and petitioner from further disclosing confidential information regarding Empire. Respondent Sitomer firm and its partners made a similar motion on June 15, 1973. In a memorandum and order dated August 23, 1973 (App. (35a), the District Court (Hon. Lloyd F. MacMahon) granted the motions.

Judge MacMahon, stating that it is "the duty of the court to examine charges of unethical conduct and to supervise the conduct of its attorneys" (App. 38a [footnote omitted]), found that petitioner had violated Canons 4 and 9.

> Goldberg had been actively involved in the preparation of Empire's registration statement. He inspected its minute books and before going to the SEC in January 1973 inspected Empire's file.

There can be no question, therefore, that Goldberg had access to client material related to the issues here. Likewise, there can be no question that he has associated with, and made disclosures to, the plaintiffs without the consent of Empire. The mere association compromises the confidences which Canon 4 seeks to protect. At the very least, when a former client is sued, he has a right to assume that his former attorneys will not voluntarily disclose what they know about the issues in litigation to the client's adversary or to his adversary's attorneys. The fact that Goldberg no longer represented Empire, or even that plaintiffs had named him as a defendant, does not relieve him of his professional responsibility.

Furthermore, association with the former client's adversary gives the appearance of impropriety. All other defendants were served; Goldberg, alone, among the named defendants was not served, and it was counsel for the plaintiffs who requested that Goldberg be dropped as a defendant. However innocent the association with the former client's adversary's counsel may have been, it clearly has the appearance of impropriety. (App. 39a-40a) (Footnotes omitted.)

Further, the Bernson firm's meeting with petitioner had led to what Judge MacMahon characterized as a "tainted association" (App. 40a), leading to its disqualification.

The injunctive portion of the order provided that:

> counsel for plaintiffs and Goldberg are enjoined and barred from acting as counsel or participating in any way with counsel for the plaintiffs in this action or in any future action against Empire involving the same transactions, occurrences, events, allegations, facts or issues, and they are further enjoined from disclosing confidential information regarding Empire to others except to comply with rulings of the court on discovery proceedings or upon trial. (App. 42a) (Emphasis added.)

The Court "[i]n light of the foregoing", dismissed the complaint without prejudice. (App. 43a)

It is to be noted that, on the date of Judge MacMahon's injunction, August

23, 1973, a year had not elapsed since January 22, 1973, when according to the determination below, the limitation period commenced to run.

Appeals were taken from Judge MacMahon's injunction by the Meyerhofer plaintiffs and the Bernson firm, and by petitioner as intervenor. The S.E.C. filed an amicus brief in which it urged the propriety of petitioner's actions. The decision on these appeals of the United States Court of Appeals for the Second Circuit, 497 F.2d 1190 (App. 44a), did not come down until June 10, 1974.

In the meantime, a second action, essentially the same as Meyerhofer, had been filed, on October 23, 1973, in the same District Court, by the same plaintiffs with different coun-

sel, and with Empire, Gross, Kaplan, the Sitomer firm and its partners all again defendants. Federman v. Empire Fire and Marine Insurance Company (73 Civil 4516 LFM).

On March 24, 1974, Empire and its officers and directors (including respondents Gross and Kaplan) finally answered the Federman complaint. (Beginning November 16, 1973, stipulations, so ordered by Judge MacMahon, had been filed, extending the times of these and the other defendants to answer, first until December 17, 1973 [within the one year limitation period], and then by similar arrangements ultimately to March 28, 1974 in the case of Empire, Gross and Kaplan.) The answer of Empire, Gross, Kaplan and other Empire officers and direc-

tors contained cross-claims against the Sitomer firm and its partners, and against petitioner and respondent Aschkenazy (an associate of the Sitomer firm), the latter two named and served as additional defendants on cross-claims. Among other things, respondents Empire, Gross and Kaplan asserted that petitioner had been guilty of malpractice in connection with the Empire public offering.

On May 24, 1974 -- before the Second Circuit's decision on the appeal in Meyerhofer from Judge MacMahon's injunction -- petitioner answered the Empire, Gross and Kaplan cross-claims, but not without first obtaining an order from Judge MacMahon, on consent, dated May 10, 1974, which provided that petitioner

could supply to and discuss with his counsel documents and information with respect to the claims against him or "any claims which Stuart Charles Goldberg may have against any other person or party with respect to the claims made against him in [Federman] which might otherwise be prohibited by the terms of this Court's aforesaid order of August 23, 1973," i.e., the injunction. This order also provided for service of petitioner's answer "without regard to the terms of this Court's aforesaid order of August 23, 1973." Clearly, it was only upon entry of this order of May 10, 1974 that petitioner became free to assert claims against respondents in which confidential information regarding Empire would be disclosed.

Petitioner's first answer of May 24, 1974, contained cross-claims against the Sitomer firm and its partners and Aschkenazy seeking indemnification in connection with the claims of Empire, Gross and Kaplan, but did not yet contain the affirmative claims against Empire, Gross, Kaplan, the Sitomer firm, its partners and Aschkenazy that are the lineal forbears of the present claims in which confidential information regarding Empire is disclosed. Those claims were asserted in petitioner's amended (as of course, pursuant to Fed. R. Civ. P. 15(a)) answer of June 14, 1974. Four days before this amended answer was served, the Second Circuit's decision had come down.

That unanimous decision, 497 F. 2d 1190 (App. 44a) represented clear judicial recognition of the full propriety of what petitioner had done. The Court said:

> Despite the breadth of paragraphs [of the Code of Professional Responsibility] EC 4-4 and DR 4-101(B), DR 4-101(C) recognizes that a lawyer may reveal confidences or secrets necessary to defend himself against "an accusation of wrongful conduct." This is exactly what Goldberg had to face when, in their original complaint, plaintiffs named him as a defendant who willfully violated the securities laws.
>
> The charge, of knowing participation in the filing of a false and misleading registration statement, was a serious one. The complaint alleged violation of criminal statutes and civil liability computable at over four million dollars. The cost in money of simply defending such an action might be very substantial. The damage to his professional reputation which might be occasioned by the mere pendency of such a charge was an even greater cause for concern.

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> Under these circumstances Goldberg had the right to make an appropriate disclosure with respect to his role in the public offering. Concomitantly, he had the right to support his version of the facts with suitable evidence. 497 F. 2d at 1194-95. (App. 52a- 53a.)

Nevertheless, the Court thought it proper:

> to ensure that a lawyer avoids representation of a party in a suit against a former client where there may be the appearance of a possible violation of confidence. To the extent that the District Court's order prohibits Goldberg from representing the interests of these or any other plaintiffs in this or similar actions, we affirm that order. We also affirm so much of the District Court's order as enjoins Goldberg from disclosing material information except on discovery or at trial. 497 F. 2d at 1196. (App. 55a.) (Emphasis in original.)

The Court went on to find that there was no basis for concluding that the relationship between the Bernson firm and petitioner was

"tainted," and reversed its disqualification and the dismissal of the complaint, concluding, in the case of petitioner:

> To the extent that the orders appealed from prohibit Goldberg from acting as a party or as an attorney for a party in any action arising out of the facts herein alleged, or from disclosing material information except on discovery or at trial, they are affirmed. Id. (App. 56a.)

The Empire defendants unsuccessfully sought rehearing, and then rehearing en banc, of the Second Circuit determination, and then petitioned this Court for a writ of certiorari. This Court denied the petition. 419 U.S. 998.

The Meyerhofer and Federman actions were thereafter consolidated, and in August of 1975, all parties, with the exception of petitioner,

entered into a stipulation of settlement, subsequently approved by the Court, under which the Sitomer firm paid $650,000 and Empire $160,000 to a fund for the benefit of Empire's defrauded stockholders.

The claims asserted in petitioner's amended answer of June 14, 1974 against the Sitomer firm and its partners, Aschkenazy, Empire, Gross and Kaplan were dismissed by Judge MacMahon on motion of those defendants on December 3, 1976, as not well-pleaded, but with leave to replead, and on December 22, 1976, petitioner served, as thus permitted, an amendment to the amended answer, a pleading containing four claims "substantially the same," the New York Supreme Court below noted (App. 15a), as the claims

in the present case. Again, defendants moved to dismiss. This time, Judge MacMahon, on April 12, 1977, understanding that the District Court had discretionary pendent jurisdiction over these claims based on state law, determined, as a matter of discretion, not to exercise that jurisdiction, and (retaining jurisdiction in case petitioner were confronted with a statute of limitations problem) stayed proceedings before him pending the commencement and final determination of an action or actions in the state courts encompassing the same claims. 74 F.R.D. 151. On appeal, the United States Court of Appeals for the Second Circuit, in a decision rendered on April 2, 1979, 597 Fed. 2d 798, determined that petitioner's claims did not

come within the scope of the federal jurisdiction, and reversed with instructions to dismiss.

On April 15, 1979, then, the present action, in the New York Supreme Court, New York County, was commenced. As the Supreme Court below noted (App. 17a), (without disagreement in the Appellate Division or Court of Appeals on this point), New York Civil Practice Law and Rules §205(a) prevents a limitations-based dismissal of petitioner's claims on the ground that they were not commenced until 1979; since they were commenced within six months of the Second Circuit's dismissal of petitioner's federal court claims, the only question is whether his federal court claims were barred by limitations.

The Complaint

The complaint dismissed below as barred by limitations set forth four causes of action. The first was for injurious involvement, and was based upon the fact that defendants engaged in a course of wrongful conduct -- essentially, the concealment of the Empire-Sitomer finder's arrangement and the filing of a false registration statement and prospectus -- in which they involved petitioner as an unknowing and innocent participant. The second cause of action sounded in fraud, and was based upon misrepresentations made by or on behalf of defendants to induce petitioner to convey information, known by them, but not by him, to be false, to the S.E.C., and to render favorable legal

opinions in connection with the Empire public offering. The third cause of action asserted a claim for breach of warranty against the Sitomer firm and its partners in connection with their employment of petitioner, based upon their misrepresentations to him concerning their competence, ethics and adherence to applicable S.E.C. regulations. The fourth cause of action asserted a claim against the Sitomer firm and its partners for fraudulently inducing petitioner to enter into and remain in their employ.

The Proceedings Below

The New York Supreme Court denied respondents' motions to dismiss the complaint. It found that all of the causes of action alleged in the

complaint seek redress for injury to reputation, that, under the New York Court of Appeal's decision in Morrison v. National Broadcasting Company, 19 N.Y. 2d 453, 227 N.E. 2d 572 (1967), "[u]nlike most torts, defamation is defined in terms of the injury, damage to reputation, and not in terms of the manner in which the injury is accomplished" (App. 7a), and that the one-year limitation period for actions for libel and slander is therefore to be applied.

One of the arguments advanced by petitioner in the New York County Supreme Court against the contention that his claims were barred by limitations was that the District Court injunction against disclosure of confidential information regarding Em-

pire, entered on August 23, 1973, tolled the running of the limitation period. "This injunction," petitioner's counsel argued, "effectively barred plaintiff from bringing any action against the defendants....[A]ny information set forth by plaintiff on his own behalf had to be 'confidential' to some degree." Memorandum of Law in Opposition to Defendants' Motion to Dismiss, at 24-25.

The New York Supreme Court (App. 12a) suggested that petitioner's service of his first pleading in Federman on May 24, 1974, was an indication that Judge MacMahon's injunction did not operate as a stay. But counsel in the Supreme Court was unaware of the May 10, 1974, District Court order permitting petitioner to

answer without regard to the terms of the injunction, and was therefore unable to call it to the attention of the Court, whose determination of this point, it is respectfully suggested, might well have been different had that order been before it. (The May 10, 1974, order was not before the Appellate Division either. It was, however, before the New York Court of Appeals, which, under New York law, was permitted to take judicial notice of it. See, George v. Time, Inc., 259 App. Div. 324, 19 N.Y.S. 2d 385 [1st Dep't 1940], aff'd 287 N.Y. 742, 39 N.E. 2d 941 [1942].)

It was also urged in the Supreme Court, arguendo, that the effect of the District Court's injunction could not be considered as limited to the

narrowest arguable reading of its terms:

> Even if defendants argue that [the] Federal Court's order of August 23, 1973 did not in fact bar plaintiff from bringing his counter and cross-claims, it must be remembered that an injunction issued by a federal court is entitled not only to compliance with the letter but also with the spirit. Plaintiff should not be prejudiced for having complied fully with the injunction. As an attorney who had been once charged with even the "appearance" of unethical conduct, there was no reason for him to proceed at his peril or to risk a contempt order. Memorandum of Law in Opposition to Defendants' Motion to Dismiss, at 25-26.

The New York Supreme Court found in petitioner's favor on a different ground however: the causes of action alleged in the complaint, it held, were not barred by the one-year limitation period (even though, in its view, Judge MacMahon's injunction did not toll the running of the statute)

because, under New York's Civil Practice Law and Rules §203(c), the assertion of petitioner's claims in Federman related back to the date when the complaint in that action was served -- a date within the one-year period.

Finally, the New York Supreme Court denied respondents' motion to dismiss the complaint for failure to state a cause of action. Its decision in this respect (except as to two items of damage alleged to flow from events subsequent to January 22, 1973) was not disturbed by the Appellate Division or the Court of Appeals.

On reargument, the Supreme Court, on April 8, 1983 (App. 24a) adhered to its original determination.

In the Appellate Division, petitioner sought to uphold the decision of the New York Supreme Court on the ground on which that Court had found in his favor and which respondents now attacked. Petitioner did not, in the Appellate Division, rely on the alternative ground of the tolling effected by the District Court injunction. (Under New York law, the question, presented to the Supreme Court, was preserved for review by the Court of Appeals, even though not argued in the Appellate Division. "If the question is properly presented in the court of first instance, it is available in the Court of Appeals even though not suggested in the Appellate Division." Cohen & Karger, The Powers of the New York Court of Appeals, [1951], at 624 n.1. [Citations omitted.])

The New York Appellate Division also found a one-year limitation period to be required by Morrison, supra. It differed from the Supreme Court, however, in its reading of New York Civil Practice Law and Rules §203(c):

> For purposes of CPLR 203(subd [c]), the "complaint" must be deemed to be a pleading in which a claim is asserted against the party claiming that the statute is tolled, i.e., the cross claim or third-party claim by the original defendants in the Federal action interposed March 24, 1974 against the present plaintiff. 97 A.D. 2d at 119, 469 N.Y.S. 2d at 84. (App. 32 a.)

Since more than a year had then elapsed from January 22, 1973 (when, according to the Appellate Division, the statute began to run), petitioner's claims, in the Court's view, were barred.

In the Court of Appeals, petitioner emphasized the effect of the District Court's order of August 23, 1973 enjoining disclosure of confidential information regarding Empire as effecting a stay which, under New York Civil Practice Law and Rules §204(a), tolled the running of any limitation period. Appellant's Brief, February 29, 1984, at 20-25; see also, Appellant's Reply Brief, May 21, 1984, at 9-13. It was shown that, if the period from the date on which the District Court enjoined petitioner from disclosing confidential information, August 23, 1973, to the date on which it permitted him to answer "without regard to the terms" of the

injunction, May 10, 1974, is deducted from the one year limitation period beginning January 22, 1973, then the complaint cannot be dismissed as barred by limitations. It was also shown that the injunction could not reasonably be read in any other way than as a stay.

> And, plainly, the assertion of claims relating to the concealment of the Sitomer-Empire finder's arrangement and the filing of Empire's false registration statement and the dissemination of its false prospectus, would necessarily entail disclosure of what would be regarded as "confidential information of Empire." No counsel could have advised Mr. Goldberg to subject himself to the possible consequences of even the smallest disclosure (including incarceration for contempt). Thus, even when Mr. Goldberg had to answer the claims against him contained in the answer of Empire and its officers and directors in Federman, an order permitting him to do so free of the restrictions of the injunction was first obtained -- on the consent of, among others, counsel for all parties who are defendants here.

> It is clear that, at the time, everyone concerned regarded Judge MacMahon's injunction as more than sufficient to stay the assertion by Mr. Goldberg of claims of the nature of those he asserts here. Appellant's Brief at 21-22. (Footnotes omitted.) (Emphasis in original.)

The New York Court of Appeals, however, did not address the question whether the injunction had stayed petitioner from asserting his claims, affirming only "for reasons stated in the opinion by Justice Samuel J. Silverman at the Appellate Division" (App. 34a), which opinion had not addressed the issue either. Mr. Justice Silverman's opinion, however, does not set out an independent state ground for the result below, since, even accepting his computation of the limitation period, petitioner's claims could not be barred if Judge MacMahon's injunction is recognized as a stay.

Reasons for Granting the Writ

The determination below should be reviewed by this Court for two reasons.

I - The Determination of the New York Court of Appeals Fails to Give Due Recognition to the Authority of an Order of a Federal Court

Petitioner's complaint could not have been dismissed as barred by limitations had the New York Court of Appeals recognized Judge MacMahon's injunction as an effective stay of the filing by petitioner of his claims.

The decision of the Appellate Division, adopted by the Court of Appeals, calculated that petitioner's claims arose on January 22, 1973, and that they were interposed (by relation back) as of March 24, 1974 (App. 32a).

Judge MacMahon's injunction was entered on August 23, 1973, after 213 days of the one year limitation period had expired. The injunction was lifted, for the limited purpose of allowing petitioner to answer the claims of Empire and its officers and directors, on May 10, 1974, on which date, it may be accepted, the statute again began to run. On June 14, 1974, the forbears of petitioner's present claims were filed, in his amended answer, only 35 days having elapsed since the injunction had been lifted. Thus, if Judge MacMahon's injunction had been recognized as tolling the statute, petitioner's claims were interposed within 248 days of the commencement of the limitations period, and the complaint could not have been dismissed as barred by limitations.

New York Civil Practice Law and Rules §204(a) provides that "[w]here the commencement of an action has been stayed by a court..., the duration of the stay is not a part of the time within which the action must be commenced." This statute is a reflection of a general principle requiring the tolling of statutes of limitation in a variety of situations where a party is unable to assert a claim. Statutes of limitation "are enacted upon the presumption that one having a well founded claim will not delay enforcing it beyond a reasonable time, if he has the power to sue.... But the basis of presumption is gone whenever the ability to resort to the courts has been taken away." United States v.

Wiley, 11 Wall. (78 U.S.) 508(1871), at 513-514. One such situation was described in Yoder v. Nu-Enamel Corporation, 145 F. 2d 420 (8th Cir. 1944).

> It appears to be the general rule, either by statute or by judicial decision, that, while a party is prevented from enforcing a legal right by some paramount authority, the statute of limitations ordinarily is not treated as running against the right. 34 Am. Jur., Limitation of Actions, §187. The term "paramount authority" in this use, as applied to a judicial act, generally has a broader meaning than merely a decree of formal injunction. 145 F. 2d at 427.

Here, Judge MacMahon's injunction was just such a "paramount authority" which -- by preventing petitioner from drawing a complaint that would say what it had to say about Empire -- effectively prevented him from enforc-

ing a legal right, in the words of Yoder, and took away his ability to resort to the courts, in the words of Wiley.

That Judge MacMahon's injunction did prevent petitioner from asserting his claims is clear. By its terms, it prevented him "from disclosing confidential information regarding Empire to others except to comply with rulings of the court on discovery proceedings or upon trial." And, under 18 U.S.C. §401, disobedience would have been punishable as contempt, by imprisonment as well as by fine, at the discretion of a Judge who had just found petitioner to have violated his ethical obligations as a lawyer. Plainly, the assertion of claims relating to the concealment of the

Sitomer-Empire finder's arrangement in Empire's false registration statement and prospectus would, of necessity, entail disclosure of what would be regarded as "confidential information regarding Empire". Equally plainly, the exception to the injunction ("to comply with rulings of the court on discovery proceedings or upon trial") would not apply to the assertion of claims against Empire or others. The filing of the claims, then, without more, would have constituted a violation, punishable by contempt, of Judge MacMahon's injunction.

Respondents' suggestion below, that petitioner should have sought to be relieved of the injunction, for the

sole purpose of asserting his claims, before he was compelled to seek to be relieved when claims were asserted against him, is not well taken. Petitioner could hardly have been expected, while he was appealing from the injunction, to have asked Judge MacMahon to create an exception to it so as to permit disclosure of "confidential information regarding Empire" for the sole purpose of asserting claims, when the same Court had already condemned as unethical disclosures made for the purpose of defending himself. Further, as a matter of law, a party stayed within the intendment of New York Civil Practice Law and Rules §204(a) need not pursue his claims under an ad hoc exemption to

the stay, but rather is protected by the statute against the running of a limitations period. See, In re Yale Express System, Inc., 438 F. 2d 101 (2d Cir. 1971).

When, however, the claims asserted against petitioner by Empire and certain of its officers and directors put petitioner in a position where he had to plead (or default), then he obtained permission, by the May 10, 1974 order, to plead without regard to the terms of the injunction and, on June 14, 1974, now free to do so under the terms of that permission -- and, of very great importance, his behavior now justified by the Second Circuit -- he asserted his claims, by amendment as of course under Fed. R. Civ. P. 15(a).

Petitioner's obligation to obey Judge MacMahon's injunction was an obligation to a federal court. His correlative assertion that he was, while unable to put forward his claims because of the injunction, entitled to a tolling under the New York statute, is the assertion of a federal right. The failure of the New York Court of Appeals to recognize that right is reviewable by this Court. In Ward v. Love County, 253 U.S. 17 (1920), where claims of illegal taxation of land by local authorities had been dismissed by the Supreme Court of Oklahoma, the petitioners successfully obtained review by this Court on the ground that their claim to be exempt from taxation was based on a federal right.

> The right to the exemption was a Federal right, and was specially set up and claimed as such in the petition. Whether the right was denied, or not given due recognition, by the supreme court [of Oklahoma], is a question as to which the claimants were entitled to invoke our judgment, and this they have done in the appropriate way. It therefore is within our province to inquire not only whether the right was denied in express terms, but also whether it was denied in substance and effect, as by putting forward non-Federal grounds of decision that were without any fair or substantial support. 253 U.S. at 22.

Here, too, petitoner sets up a federal right (indeed, obligation) -- to obey Judge MacMahon's injunction -- as a defense to, or "exemption" from, state action -- the imposition of a limitations period -- and that state action is reviewable by this Court.

To permit State courts simply to ignore the existence of orders of federal courts, as was done here, would

make federalism unworkable. In Testa v. Katt, 330 U.S. 386 (1947) this Court held that the courts of the States were obligated to recognize federally created causes of action. On the same principle of federal supremacy that compelled that decision, it should, a fortiori, be found that State courts are obligated to recognize the force and effect of orders issued by federal courts. Here, the New York Court of Appeals, by failing to give such effect to Judge MacMahon's injunction, fell far short of that principle.

II - The Determination of the New York Court of Appeals Will Have a Chilling Effect on the Proper Enforcement of the Securities Laws

The decision below cannot but have a strongly negative effect on the proper enforcement of the federal securities laws.

Petitioner's dismissed claims seek recovery of damages due, in the last analysis, to the fact that respondents' conspiracy to violate the securities laws forced petitioner to go to the S.E.C., in order to remedy respondents' illegal doings and to prevent further fraud. As a result, petitioner suffered loss of employment, public vilification, the substantial turmoil and expense of being caught up in investigations and major litigation, and emotional and physical

distress. Had respondents not flouted the securities laws, or had petitioner gone along with respondents' attempts at a cover-up, in either event petitioner would not have been damaged as he was.

Respondents themselves then obtained the District Court order which, while operative, effectively prevented petitioner from seeking redress for his damages. Now that petitioner has asserted his claims for redress, however, respondents urge that the District Court order obtained by them did not really prevent him from doing anything. Such a position is not simply wrong, but will have a dangerous consequence. The New York Courts below have said, in substance, that petitioner's damage --due to respond-

ents' fraud and petitioner's adherance to law and his ethical obligations as a lawyer -- could only have been made whole if petitioner had run the risk of disobeying the District Court injunction that respondents themselves obtained. Such a result -- forcing a choice between foregoing claims or being subject to punishment for contempt -- will not encourage the next lawyer caught in such a situation to do his duty at a personal cost not only great but, under the result below, irremediable as a practical matter.

The S.E.C. itself has forcefully described the sort of adverse impact a lawyer aware of securities fraud and taking the proper course, as petitioner did, can expect to face, and the dangers to enforcement of the securi-

ties laws that are posed. It argued as amicus on the appeal from the August 23, 1973 District Court injunction that:

> Yet, as Mr. Goldberg's experience demonstrates, a likely and forseeable consequence of reporting fraudulent conduct to the Commission is the public disclosure of that fraudulent conduct, and a private civil action precipitated by the public disclosure. Where the attorney who has disclosed the fraud is associated with the fraudulent conduct or representations, he is likely to be made a defendant in the private action. In other words, to come to the Commission is to invite being sued, and the district court's opinion stands for the proposition that the defendant attorney cannot eliminate himself from the lawsuit by informally establishing his innocence to the plaintiffs' attorney. Rather he must participate in the litigation and bear the attendant burden and expense, including the clouding of his professional reputation, in order to establish his non-culpability. Such a likely and forseeable consequence of reporting fraudulent conduct to

> the Commission will surely discourage attorneys from fulfilling their profesional obligations, and thus will frustrate the disclosure philosophy of the federal securities laws. Brief of the Securities and Exchange Commission Amicus Curiae, October 23, 1973, at 16.

Here, petitioner has been penalized for obeying an order, obtained by respondents themselves in a situation brought about by respondents' own wrongdoing. As a result of the erroneous failure of the New York Court of Appeals to recognize the force and effect of that order, petitoner has been prevented from seeking any redress for the "likely and forseeable consequence of reporting fraudulent conduct to the Commission". The determination below, therefore, places a discouraging and ufair obstacle in the way of a lawyer willing to do the

right thing when faced with a securities fraud.

The result, too, is a sad footnote to the Second Circuit's decision upholding the ethical character of what petitioner did. That decision has become a subject for study in major law school legal ethics teaching materials, being reproduced in at least substantial part in Kaufman, Problems in Professional Responsibility, 2d ed. (1984), at 231, Mellinkoff, Lawyers and the System of Justice, (1976), at 696, and Patterson, Legal Ethics: The Law of Professional Responsibility, (1982), at 5-44. The sequel, that petitioner could not even have a day in court against the wrongdoers because he obeyed an order of a United States District Court, will not

encourage students to do what some of them, some day, may be called upon to do.

CONCLUSION

A writ of certiorari should be granted to review the judgment of the New York Court of Appeals.

Respectfully submitted,

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APPENDIX

SUPREME COURT OF THE STATE OF NEW YORK
COUNTY OF NEW YORK: SPECIAL TERM, PART I
- -X
STUART C. GOLDBERG,

Plaintiff,

-against-

SITOMER, SITOMER & PORGES, ALVIN LESTER SITOMER, STEPHEN JOEL SITOMER, ROBERT E. PORGES, JACOB ASCHKENASY, EMPIRE FIRE AND MARINE INSURANCE COMPANY, GARY O. GROSS and YALE J. KAPLAN,

Defendants.
- -X

Greenfield, J.:

These three motions by defendants to dismiss the complaint, numbered 35, 36 and 37 are consolidated herein for disposition.

This is an action to recover damages based on defendants' alleged fraud, breach of warranty and injurious involvement of plaintiff in the wrongful activities of defendant. All defendants have moved to dismiss the

complaint as barred by the Statute of Limitations or for failure to state a cause of action.*

Plaintiff, a lawyer, alleges that as an employee of the defendant law firm, Sitomer, Sitomer & Porges (the Sitomer firm), he relied on material and false representations concerning the fee arrangment with co-defendant Empire in preparing a security offering statement for filing with the Securities and Exchange Commission. These offerings eventually resulted in an investigation by the Securities and Exchange Commission and civil actions in the federal courts. Plaintiff, accused of wrongdoing, here seeks

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* Defendant Porges has withdrawn as a movant pursuant to CPLR 3211(e). Defendant Aschkenasy's motion is based solely on CPLR 3211(a)(5).

damages based on fraud as to the true fee arrangement, for fraud and breach of warranty in his employment agreement with the law firm in that in accepting employment he relied upon their false representations in warranting that the firm adhered to the requirements of the Code of Professional Responsibility and observed and abided by the applicable regulations of the SEC: and for his innocent involvement in these acts, which made him appear to be a participant and tainted him with wrongdoing.

The first two causes of action denominated as "tortious involvement" and "fraud", are asserted against all defendants.** The third and fourth

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** The defendants are the Sitomer firm; its partners, (cumulatively

asserted only against the defendant law firm and its partners, sound in breach of warranty and fraudulent inducement.

The first of defendants' arguments for dismissal rest on the assertion that all the claims are for redress of injury to reputation and thus the one year Statute of Limitations for libel and slander applies, citing, inter alia, Morrison v. National Broadcasting Co. Inc., 19 NY 2d 453. As the Court there noted in applying a Statute of Limitations, the court must look for the reality and the essence of the action and not the appellation

[fn. ctd.] referred to as the Sitomer defendants); Aschkenasy, an associate of the firm; Gross and Kaplan, who were officers and directors of Empire; and Empire, the client for which the offering statements were prepared.

either party may use to describe the claim.

The first cause of action, which plaintiff labels "unconventional" is in fact based upon a claim of deceitful conduct resulting in defamation by involuntary association and without his consent. This claim is neither novel or unconventional. In Davidson v. National Broadcasting Co. (26 Misc. 2d 936), Mr. Justice Vincent A. Lupiano sustained a similar cause of action where plaintiff, an attorney, had appeared and participated as a contestant in the television quiz show "21." After investigation by Grand Juries and other public bodies, it became known that the show had been, at least in part, rigged and thereafter, the

defendants discontinued the program. The result was that the public believed that the contestants, including plaintiff, were privy to the dishonesty. (See also Holt v. Columbia Broadcasting Systems, Inc., 22 AD 2d 791). Such a cause of action carries with it the one-year Statute of Limitations applicable in all libel and slander cases. (Morrison v. N.B.C., supra). Similarly, the second cause of action alleging fraud, and relying on the core of facts set forth in the first cause of action specifically seeks redress for injury to reputation, and it, too, carries a one-year Statute of Limitations (Korry v. IT&T Corp., 444 F. Supp 193). The third and fourth causes of action, although denominated "breach of warranty" and

"fraudulent inducement" and based on alleged warranties and misrepresentations concerning the character of the defendant law firm in inducing plaintiff to become associated with it, again seek damages based on the same consequences as the first and second causes of action.

Unlike most torts, defamation is defined in terms of the injury, damage to reputation, and not in terms of the manner in which the injury is accomplished. (Morrison, supra, at 458). Thus, to the extent the complaint, by its terms, states any cause of action, it can only sound in defamation which necessarily carries a one-year Statute of Limitations for all the claims asserted.

Application of that statute, how-

ever, does not, ipso facto, bar the claim. As conceded by all movants, the earliest this claim may have arisen was January 20, 1973, when the alleged wrongdoing first came to light.

Plaintiff contends that even if the one year Statute of Limitations is applied, it should be tolled during the entire pendency of the federal action. Plaintiff also contends that the one year Statute of Limitations should be tolled because he had been enjoined from asserting these rights.

After plaintiff made his disclosures to the SEC in January, 1973, Empire made public disclosure of its fee arrangement in its annual report filed with the SEC on April 12, 1973.

On May 2, 1973, Dietrich Meyerhoffer brought suit in the Southern District against Empire, the Sitomer firm and its partners and plaintiff, Goldberg, for violation of securities law. Plaintiff learned that he was named a co-defendant in that suit and thereupon met with Meyerhoffer's counsel to clear himself. As a result of the conversations between plaintiff and Meyerhoffer's counsel, plaintiff was dropped as a defendant.

On August 23, 1973, upon a motion of the defendants in the Meyerhoffer case to disqualify Meyerhoffer's counsel, the District Court (MacMahon, J.) ruled that Meyerhoffer's counsel and plaintiff (Goldberg):

> "***are enjoined and barred from acting as counselor participating in any way with counsel for

> [Meyerhoffer] plaintiffs in this action or in any future action against Empire involving the same transactions, occurrences, events, allegations, facts or issues, and they are further enjoined from disclosing confidential information regarding Empire to others except to comply with rulings of the court on discovery proceedings or upon trial." (Typescript at p. 11).

The complaint was dismissed without prejudice.

On June 10, 1974, the Second Circuit Court of Appeals (497 F. 2d 1190, cert. den. 419 U.S. 998) reversed the district court's order of dismissal and the grant of injunctive relief except it affirmed the lower court's opinion to the extent that it prohibited Goldberg from representing the interests of these or other plaintiffs in the Meyerhoffer or similar actions (emphasis in original). It also

affirmed "***so much of the District Court's order as enjoins Goldberg from disclosing material information except on discovery or at trial." (497 F. 2d at 1196).

Thus, Goldberg's argument that the Statute of Limitations should be tolled for the nine and one-half months (August 23, 1973 to June 10, 1974) during which he was under the District Court's order of injunction must fail since the injunction against him was continued by the Second Circuit. Moreover, Goldberg's answer (to Empire's cross-claims) which included cross-claims was served two weeks prior to the decision of the Second Circuit.

It is clear that any restraint that he was under pursuant to Judge

MacMahon's order was continued by the Second Circuit. It would therefor appear that the reason no cross-claim was instituted by him against the Sitomer defendants or Aschkenasy was due to the fact that he was not brought into the federal actions until March 24, 1974, when Empire served its answer and asserted claims against Goldberg. Disposing of plaintiff's argument with respect to a tolling of the Statute of Limitations during the period of the injunction does not, however, settle the parties' arguments with respect to tolling of the Statute of Limitations during the entire pendency of the federal action.

On June 5, 1973, while the appeal in Meyerhoffer was pending, Herbert Federman brought suit. Like the

Meyerhoffer complaint, the Federman complaint charged violations of the Securities Act of 1933, the Securities Exchange Act of 1934, SEC Rule 10b-5 and common law negligence, fraud and deceit. The Federman and Meyerhoffer suits were consolidated by order dated December 30, 1974.

On March 24, 1974, Empire served its answer in which in addition to denials and affirmative defenses, cross-claimed against the Sitomer defendants, and Goldberg and Aschkenasy as additional defendants.

Empire's cross-claims alleged negligence and malpractice in the preparation of the registration statement. Goldberg served his initial answer to Empire's cross-claims on May 27, 1974. In addition to denials and affirmative

defenses to Empire's claims, he filed three cross-claims, one against the Sitomer defendants for indemnification and two against the Sitomer defendants and Aschkenasy for indemnification and contribution. On June 16, 1974, Goldberg amended his answer and added a counterclaim against Empire and a cross-claim against the Sitomer defendants and Aschkenasy for damage to his reputation, loss of his employment and attorney's fees. (See Federman v. Empire, 597 F. 2d 798).

On August 22, 1975, all parties with the exception of Goldberg entered into a stipulation of settlement which was approved by the District Court. Remaining outstanding were the claims asserted by and against Goldberg.

Thereafter, Empire, the Sitomer

defendants and Aschkenasy moved pursuant to Rule 12(b)(6), Fed. R. Civ. P., to dismiss the claims against them for legal insufficiency which motion was granted by order of Judge MacMahon filed December 7, 1976. The order allowed Goldberg to further amend his pleadings which was accomplished on December 22, 1976 when he served an amendment to his amended answer. The four claims then asserted were substantially the same as those pressed in this court. Upon another motion to dismiss, Judge MacMahon denied that relief and retained pendent jurisdiction but suspended all further proceedings pending the commencement and final determination of an action(s) in the state court (Meyerhoffer v. Empire, 74 FRD 151 [S.D.N.Y., 1977]).

On appeal, decided April 2, 1979, the Second Circuit reversed and ordered the dismissal of all cross-claims and counterclaims. The court stated that for the purpose of invoking federal ancillary jurisdiction (FRCP Equity Rule 12) "***it cannot be stated that they arise out of the same transaction or occurrence" as set forth in the complaint. (Federman v. Empire, 597 F. 2d 798, 812). The court noted that Goldberg's claims were state law claims and as such the district court could not "***exercise its ancillary power of jurisdiction over them unless there exists some independent jurisdictional base such as the existence of a federal question upon which federal jurisdiction may be founded." (597 F. 2d at p. 812).

Here it is clear that notwithstanding the fact that the Second Circuit opinion determined that Goldberg's claims did not arise out of the same transactions or occurrences as set forth in the complaint, Goldberg's claims would relate back to the date of service of the complaint since pursuant to CPLR §203(c) Goldberg's claims would not have been time barred on May 5, 1973 when the Federman complaint was served.

Thus, the Statute of Limitations was tolled throughout the entire pendency of the federal action. (CPLR 205[a]; Neuberger, Loeb & Co. v. Gross, [2nd Cir. 1977], 563 F. 2d 1057). Although the claims asserted by plaintiff while a defendant in the federal action were not interposed

until May, 1974, they were timely under both state and federal procedure, (CPLR 203[c]; FRCP 15[c]) since they relate back to the time of the filing of the original complaint. This rule is also applicable to cross-claims (Seligson v. Chase Manhattan Bank, N.A., 50 AD 2d 206). This action therefore, was commenced well within the one year Statute of Limitations period for defamation actions, it is not to be barred by CPLR 3211(a)(5), and that part of each motion based on the Statute of Limitations is denied.

Turning now to the sufficiency of the complaint, the court will for those purposes assume the pleadings to be true. Defendants' first objection is predicated upon CPLR §3016(a) which

requires that in any action for libel or slander, the particular words complained of be set forth. Here, however, the defamation occurred not as a result of particular words, but rather as a result of the scenario created by the actions, and failures to act by the defendants. Thus, as in the T.V. quiz show cases, the defamation is not "in any particular words spoken but in the T.V. presentation of a program and contestant exposed as dishonest" (Davidson v. NBC, supra at p. 938).

Next, defendants argue that any communication made to plaintiff during the period of his employment for defendant, were qualifiedly privileged and plaintiff has failed to allege

malice which is necessary to defeat the privilege citing Shapiro v. Health Insurance Plan of Greater N.Y. (7 NY 2d 56) and Stillman v. Ford (22 NY 2d 48). In Shapiro, plaintiff was a doctor suing defendant non-profit membership corporation which sold medical indemnity insurance. The essence of plaintiff's complaint was that he was denied membership based upon defamatory opinions concerning his professional competence. In Stillman, plaintiff, the former president of defendant non-profit educational foundation alleged that he was forced to resign after executive committee members published defamatory letters disparaging him following a dispute over policy.

In both cases, the court held that qualified privilege protected the defendants. "A communication made bona fide upon any subject matter in which the party communicating has an interest, or in reference to which he has a duty, is privileged if made to a person having a corresponding interest or duty, although it contained incriminating matter which, without this privilege would be***actionable***." (Shapiro v. Health Insurance Plan of Greater New York, supra at p. 60).

These cases are clearly distinguishable since the allegations of the complaint are not concerned with the communications and actions of the defendants' inter se but address those actions and communications made directly to the plaintiff. Thus, proof

of malice is not necessary.

Even were malice a necessary element, where, as here, statements, actions and assurances are made to a party that the functions to be performed by him are bona fide and legal when the person or persons taking such action or making such statements knew or should have known that they were false and by so doing subjects the party to both civil and criminal liability, and where, were it not for the intentional camouflage of the true state of affairs the party would never have undertaken the duties assigned to him, malice may be presumed. It is the public policy of this state that no privilege can attach to false statements which induce a party to perform illegal acts.

Futhermore, this court notes that plaintiff has pleaded special damages (Gurtier v. Union Parts Mfg. Co., 1 NY 2d 5; See also Salamone v. MacMillan Publishing Co., Inc., 77 AD 2d 501; Holt v. Columbia Broadcasting Systems, Inc., 22 AD 2d 791). With respect to each cause of action, plaintiff alleges lost wages in the amount of $16,187.00, legal expenses in the amount of $46,455.16 and medical expenses in the amount of $610.00.

Accordingly, that portion of the motion seeking to dismiss for failure to state a cause of action is also denied.

Dated: Oct 28 1981

SUPREME COURT OF THE STATE OF NEW YORK
COUNTY OF NEW YORK: SPECIAL TERM,
PART I

- -X

STUART C. GOLDBERG,

Plaintiff,

-against-

SITOMER, SITOMER & PORGES, ALVIN LESTER SITOMER, STEPHEN JOEL SITOMER, ROBERT E. PORGES, JACOB ASCHKENASY, EMPIRE FIRE AND MARINE INSURANCE COMPANY, GARY O. GROSS and YALE J. KAPLAN,

Defendants.

- -X

Greenfield, J.:

Motion to reargue the prior order of this court dated October 28, 1981 is granted and upon such reargument the court adheres to its original determination.

Defendants contend that under Seligson v. Chase Manhattan Bank, 50 AD 2d 206, 209-10, relied on in part

by this court in its original determination, plaintiff's cross-claim in the federal action can at best only relate back to the cross-claim interposed against him by Empire. It is therefore argued that since the Empire cross-claim was interposed in March 1974, plaintiff's cross-claim is time-barred.

While the opinion of the court in Seligson is not altogether clear (see Joseph M. McLaughlin, Supplementary Practice Commentaries C 203:9 (1976), Supp. at 54) it would appear that the rule to be gleaned from that case would only apply in those situations where the challenged cross-claiming defendants' claim did not arise out of the facts or circumstances asserted on either the other cross-claiming

defendants' claims or the plaintiff's complaint. In this case, however, it is clear that Goldberg's cross-claim arose out of the same facts and circumstances asserted in Empire's cross-claim against him and the original complaint served by Federman.

Defendants' argument that the Second Circuit's statement that Goldberg's claim did not arise out of the transaction and occurrences set forth in the complaint (Federman v. Empire, 597 F. 2d 798, 812) collaterally estops plaintiff is without merit. The Second Circuit determination was strictly jurisdictional regarding the power of the district court to retain ancillary jurisdiction and in no way purported to address the substantive claims.

Dated: Apr 8 1983

STUART C. GOLDBERG, Respondent, v SITOMER, SITOMER & PORGES et al., Appellants, et al., Defendant.

APPEARANCES OF COUNSEL

Harold Davis and *Paul B. Garland* of counsel (*Davis & Davis*, attorneys), for Jacob Aschkenasy, appellant.

Alan Kanzer of counsel (*George Berlstein* with him on the brief; *Walter, Conston & Schurtman, P. C.*, attorneys), for Empire Fire and Marine Insurance Company and others, appellants.

Robert E. Meshel of counsel (*Timothy P. Butler* with him on the brief; *D'Amato & Lynch*, attorneys), for Sitomer, Sitomer & Porges and others, appellants.

Harry E. Youtt for respondent.

OPINION OF THE COURT

SILVERMAN, J.

These are appeals from orders of the Supreme Court, Special Term, denying defendants' motions to dismiss the complaint on the grounds of Statute of Limitations and failure to state a cause of action.

Plaintiff, a lawyer, alleges that he was employed as an associate by the law firm of the defendants Sitomer, Sitomer and Porges; that in the course of his work he was called upon to participate in the preparation of a registration statement for filing with the Securities and Exchange Commission on behalf of the corporate defendant Empire, a client of the firm; that the nature of the retainer agreement between Empire and the firm was misrepresented to him, and that it was therefore inaccurately stated in the registration statement; that when he found out about the inaccuracy and defendants refused to correct it, he resigned his position with the firm, and on January 22, 1973 he went to the Securities and Exchange Commission himself and made a full disclosure. In this action he claims damages by reason of the defendants having caused him to be involved in a false registration statement with the result that (a) some persons thought he had knowingly participated in the making of such a false statement, and (b) that other firms would not employ him, either for that reason, or because they thought he was a "whistle blower".

[1] The claims in the complaint in reality are claims for defamation or "false words causing special damages" governed by the one-year Statute of Limitations of CPLR 215 (subd 3). The controlling case is *Morrison v National Broadcasting Co.* (19 NY2d 453). The Court of Appeals said (pp 458-459): "The broad reach of the common-law cause of action for defamation is indicated in the Restatement of Torts. 'A communication is defamatory', its authors have written (§ 559), 'if it tends so to harm the reputation of another as to lower him in the estimation of the community or to deter third persons from associating or dealing with him.' Thus, unlike most torts, defamation is defined in terms of the injury, damage to reputation, and not in terms of the manner in which the injury is accomplished. This is borne out by Comment *a* to section 559, where it is noted that 'The word "communication" is used to denote the fact that one person has brought an idea to the perception of another.' In the case before us, the plaintiff complains, in effect, that the defendants' conduct 'brought an idea' that he was dishonest 'to the perception' of the general public."

Here the entire injury complained of by plaintiff flows from the effect on his reputation — what people thought about him — either (a) falsely as having knowingly participated in having made a false registration statement with respect to a public issue of securities, or (b) truly as a "whistle blower", one who would not remain silent when he discovered wrongful and unethical conduct by his associates, at least with respect to matters in which he was involved. Each cause of action in the complaint defines the damage to plaintiff in terms of paragraph 29 of the complaint, which in turn recites damages all arising from injury to his reputation, i.e., in essence that the actions complained of tended "so to harm the reputation of [plaintiff] as to lower him in the estimation of the community or to deter third persons from associating or dealing with him." (19 NY2d, at p 458.)

It does not matter that plaintiff chose to call his claims "tort of injurious involvement", "fraud", "breach of warranty", and "fraudulent inducement". As the Court of Appeals said in *Morrison v National Broadcasting Co.*

(*supra*, p 459): "In applying a Statute of Limitations, this court declared some years ago, 'We look for the reality, and the essence of the action and not its mere name.' (*Brick v. Cohn-Hall-Marx Co.*, 276 N. Y. 259, 264.) Concluding as we do that this cause of action sounds in defamation, it would be highly unreal and unreasonable to apply some Statute of Limitations other than the one which the Legislature has prescribed for the traditional defamatory torts of libel and slander * * * A contrary result might very well enable plaintiffs in libel and slander cases to circumvent the otherwise short limitations period by the simple expedient of 'redescribing [the] defamation action to fit this new "noncategory" ' of intentional wrong."

[2] Two of the items of damages, alleged in paragraph 29 of the complaint, are alleged to flow from conduct of defendants after January 22, 1973. These are the items in subdivisions (c) and (d) of paragraph 29 of the complaint, that plaintiff "became the brunt of a malicious campaign of vilification and ridicule directed by" certain of the defendants, and that plaintiff "became the subject of numerous assertions" initiated by those defendants to the effect that he had been a knowing and culpable wrongdoer in the securities law violations. These allegations, however, fail to state a cause of action because they do not comply with the requirements of CPLR 3016 (subd [a]) that in libel and slander cases "the particular words complained of shall be set forth in the complaint", nor with the requirement of CPLR 3013 that: "Statements in a pleading shall be sufficiently particular to give the court and parties notice of the transactions, occurrences, or series of transactions or occurrences, intended to be proved and the material elements of each cause of action or defense."

[1] With these two exceptions the remainder of the claims all relate to conduct of the defendants complete and known to plaintiff (and disclosed by him to the Securities and Exchange Commission) by January 22, 1973 so that the cause of action accrued not later than that date. The present action was begun on April 15, 1979, more than six years after the claim accrued.

[3] The Statute of Limitations, as we have said, is one year. However, under CPLR 205 (subd [a]), if a previous

action had been timely commenced by plaintiff and terminated in any other manner than by voluntary discontinuance, judgment on the merits, etc., the plaintiff may commence a new action on the same cause of action within six months after the termination. Here plaintiff claims and Special Term gives plaintiff the benefit of that section on the ground that the plaintiff had timely asserted the present claims in a previous action in the Federal court, which was terminated less than six months before the commencement of this action. We disagree with Special Term in that we hold that the plaintiff's claim in the Federal court action was not "timely commenced" or asserted.

The action in the Federal court was originally brought on May 2, 1973 by some securities holders against defendant Empire based on the false registration statement. Plaintiff was not a party to that action until March 24, 1974 when the defendant in that action served its answer in which it included cross claims or third-party claims against plaintiff and others as additional defendants. This was the first time that a pleading contained any claim against plaintiff and that he was served and made a party. This was, of course, more than one year after January 22, 1973 when plaintiff's claims here asserted first accrued. Thereafter on June 16, 1974 the present plaintiff amended his answer in the Federal court action to add cross claims and counterclaims against the present defendants (a counterclaim against the Empire defendants who had asserted the claim against plaintiff and cross claims against other defendants against whom Empire had asserted claims) for essentially the claims now sued on.

CPLR 203 (subd [c]) provides: "A defense or counterclaim is interposed when a pleading containing it is served. A defense or counterclaim is not barred if it was not barred at the time the claims asserted in the complaint were interposed, except that if the defense or counterclaim arose from the transactions, occurrences, or series of transactions or occurrences, upon which a claim asserted in the complaint depends, it is not barred to the extent of the demand in the complaint notwithstanding that it was barred at the time the claims asserted in the complaint were interposed."

Special Term held that under this statute the cross claim asserted by the present plaintiff in the Federal action was

deemed to have been interposed at the time that action was originally commenced in the Federal court, i.e., May 2, 1973, and was thus timely. We do not agree.

In our view, the present plaintiff's claim in the Federal action must be deemed to have been interposed on March 24, 1974 when for the first time any claim was interposed against the present plaintiff and the present plaintiff became a party to that lawsuit.

For purposes of CPLR 203 (subd [c]), the "complaint" must be deemed to be a pleading in which a claim is asserted against the party claiming that the statute is tolled, i.e., the cross claim or third-party claim by the original defendants in the Federal action interposed March 24, 1974 against the present plaintiff. That appears to be the view taken by this court in *Seligson v Chase Manhattan Bank* (50 AD2d 206), and in *Holst v Edinger* (93 AD2d 313). To hold that in these circumstances the Statute of Limitations is tolled as of the time of the service of the original complaint by the original plaintiffs would leave open the possibility that if, say, some years have elapsed between the original institution of the action and the time when a defendant in that action serves a cross claim or third-party claim against a new party, a claim that had been barred for some years would be revived. We do not think that is a fair "judicial extension" (cf. *Seligson v Chase Manhattan Bank, supra*, p 210) of the statute.

Thus, when the present plaintiff interposed the present claims in the Federal action on June 16, 1974, it was already barred as it was "barred at the time the claims asserted in the complaint [the Federal cross complaint or third-party complaint] were interposed." (CPLR 203, subd [c].)

[4] The claim is not saved by the exception in CPLR 203 (subd [c]) for claims arising out of the same transactions, etc., upon which a claim asserted in the complaint depends. This is a recoupment exception. Its effect is that if A (the present defendants) sues B (the present plaintiff), and B has some defense or counterclaim arising out of the same transaction which would be barred as an independent action, B may still assert that defense or counterclaim "to the extent of the demand in the complaint" (CPLR 203,

subd [c]). Its only reasonable application can be to a case where some demand is asserted against B. Under this exception, "no affirmative judgment can be entered in favor of the defendant [asserting the recoupment — here the present plaintiff] since a recoupment, by definition, merely permits defendant to use his claim as a defense." (McLaughlin, Practice Commentaries, McKinney's Cons Laws of NY, Book 7B, CPLR C203:9, p 119.) While the otherwise time-barred counterclaim was properly asserted in the Federal action "to the extent of the demand in the complaint", the exception has no application in this case, where no "demand" has been made against the party making the claim. Thus the "extent of the demand" against the present plaintiff is zero. And therefore, the exception has no application to the present plaintiff's complaint.

Three orders, Supreme Court, New York County (Edward J. GREENFIELD, J.), entered November 2, 1981 denying defendants' motions to dismiss the complaint, should be reversed, on the law, with costs, and the complaint dismissed.

KUPFERMAN, J. P., CARRO and BLOOM, JJ., concur.

Three orders, Supreme Court, New York County, entered on November 2, 1981, unanimously reversed, on the law, and the complaint dismissed. Appellants shall recover of respondent one bill of $75 costs and disbursements of these appeals.

No. 439

Stuart C. Goldberg,
Appellant,

v.

Sitomer, Sitomer & Porges, et al.,
Respondents,

et al.,
Defendant.

Order affirmed, with costs, for reasons stated in the opinion by Justice Samuel J. Silverman at the Appellate Division (97 AD2d 114). Chief Judge Cooke and Judges Jasen, Jones, Wachtler, Meyer, Simons and Kaye concur, Judge Meyer on constraint of Morrison v. National Broadcasting Co. (19 NY2d 453).

DECISION COURT OF APPEALS OCT 11, 1984

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

73 Civ. 1940—LFM

DIETRICH MEYERHOFER *et al.*,

Plaintiffs,

—against—

EMPIRE FIRE AND MARINE INSURANCE COMPANY *et al.*,

Defendants.

MACMAHON, *District Judge.*

Plaintiffs move under Rule 56, Fed.R.Civ.P., and Civil Rule 11A of this court for an order declaring that this action be maintained as a class action. Invoking Canons 4 and 9 of the Code of Professional Responsibility and the supervisory power of this court, the individual defendants Empire Fire and Marine Insurance Company (Empire) and Sitomer, Sitomer & Porges (Sitomer firm) cross-move for an order disqualifying plaintiffs' attorneys from representing plaintiffs in this action or associating with any other attorney in the prosecution of this action; enjoining plaintiffs, their attorneys and Stuart Charles Goldberg from further disclosing confidential information regarding Empire: directing the Clerk of the court to seal that part of the file containing confidential information; dismissing this action without prejudice; and granting such other relief as the court may deem proper. We shall consider the cross-motion first.

Empire retained the Sitomer firm to draft a registration statement in connection with a public offering of Empire stock. Goldberg, a limited partner of the law firm from November 15, 1971 until January 21, 1973, was actively involved in the preparation of the statement or in the necessary background work, such as, reviewing the minutes of Empire. The registration statement for the Empire issue was dated May 31, 1972.

In January 1973, Goldberg became aware of what he felt were material omissions concerning certain compensation agreements between the Sitomer firm and Empire. Evidently, the possibility that these agreements would become public was the subject of much discussion within the Sitomer firm. Goldberg thought that full disclosure to the Securities and Exchange Commission (SEC) was proper and obligatory. He asked his personal attorney to contact Stanley Sporkin, Deputy Director of the SEC's Division of Enforcement, explain the nature of the problem and make known Goldberg's availability to meet with the SEC to discuss the problem.

A meeting between Goldberg and SEC representatives was arranged for Monday morning, January 22, 1973. The night before this meeting, Goldberg sent telegrams to two limited partners in the Sitomer firm advising them of his immediate resignation from the firm and of his meeting with the SEC "for the purpose of making full and complete disclosure regarding the activities of the firm in regards to securities practice."

During the next week, Goldberg discussed the firm's activities with respect to the Empire registration statement and also with respect to another registration statement which the firm had been preparing. He submitted a lengthy affidavit to the SEC outlining these activities on January 26, 1973. No member of the firm participated in or ap-

peared at these discussions notwithstanding their present claims that they intended to make full disclosure. The SEC has commenced an investigation of these transactions.

Empire filed its annual report with the SEC (Form 10k) on April 12, 1973. This report made public disclosure for the first time of the compensation agreements. The report was distributed to Empire's stockholders on or before April 30, 1973.

Plaintiffs filed their original complaint on May 2, 1973 asserting that the omission of the compensation agreements from the registration statement was a violation of the securities laws.[1] Service was made on that same day on the Sitomer firm and its general partners. Plaintiffs' counsel (counsel) telephoned Goldberg on May 3, 1973, informed him that an action had been commenced and that Goldberg was named as a defendant. Goldberg denied any wrongdoing and told counsel of his efforts to have the Sitomer firm make disclosure and of his own disclosure before the SEC. Counsel agreed that if Goldberg were not involved in the alleged omissions, they would move to drop Goldberg as a party defendant. Goldberg then asked if he could see a copy of the complaint without being served.

Counsel arranged to meet Goldberg in front of counsel's office building. At this meeting on May 3, 1973 coun-

[1] The X firm and the general partners have attempted to show that counsel for plaintiffs had become aware of the firm's predicament through discussion with the X firm concerning the renting of a part of the firm's office space by counsel for plaintiffs. They evidently are trying to posit some breach of confidence by counsel or by a third party who acted as intermediary in the renting discussion. This has caused counter-charges and replies. Although there are evidently questions of fact here, we do not feel that a hearing is necessary since resolution of these issues is not necessary to determine the cross-motion.

sel requested a copy of Goldberg's SEC affidavit but he refused to disclose it until he had spoken with his own attorney and with the SEC. After discussing the matter with his attorney, Goldberg arranged to meet counsel on May 7, 1973 at counsel's office. At this meeting, he again refused to show counsel his affidavit until he had spoken with the SEC. Counsel and Goldberg then called William P. Sullivan, Special Counsel at the SEC. Mr. Sullivan stated that the SEC had no objection to disclosure of the affidavit. Goldberg then gave counsel a copy. A discussion followed.

Subsequent to this meeting, counsel moved for an order dropping Goldberg as a named defendant. We granted that motion since Goldberg had not been served and since no prejudice would accrue to any other party. Defendants now assert that their cross-motion should be granted because counsel aided and abetted a disclosure of confidential information and because counsel have failed to avoid the appearance of impropriety, in violation of Canons 4 and 9 of the Code of Professional Responsibility.

It is the duty of the court to examine charges of unethical conduct and to supervise the conduct of its attorneys.[2] When considering such charges, courts may not rely upon the good faith of the attorneys involved, but rather must apply "a strict prophylactic rule to prevent any possibility, however slight, that confidential information acquired from a client during a previous relationship may subsequently be used to the client's disadvantage."[3]

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[2] *Emle Industries, Inc.* v. *Patentex, Inc.*, 478 F.2d 562 (2d Cir. 1973); *Richardson* v. *Hamilton Int'l Corp.*, 469 F.2d 1382 (3d Cir. 1972), *cert. denied*, 41 U.S.L.W. 3608 (U.S. May 14, 1973).

[3] *Emle Industries, Inc.* v. *Patentex, Inc.*, *supra*, 478 F.2d at 571.

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Canon 4 provides that "a lawyer should preserve the confidences and secrets of a client." This obligation is broader than the evidentiary attorney-client privilege and "exists without regard to the nature or source of information or the fact that others share the knowledge."[4] Furthermore, the court does not stop to inquire whether any information which Goldberg or his firm may have disclosed to plaintiffs' counsel was in fact confidential, for such an inquiry would reveal the very confidences sought to be protected. All that need be shown, therefore, is that during the attorney-client relationship Goldberg had access to his client's information relevant to the issues here.[5]

Canon 9 provides that a "lawyer should avoid even the appearance of professional impropriety." Every effort must be made, therefore, to ensure not only that the actions of lawyers are proper but also that they appear to be so. The appearance of propriety may be as necessary as the fact.[6]

Goldberg had been actively involved in the preparation of Empire's registration statement. He inspected its minute books and before going to the SEC in January 1973 inspected Empire's file. There can be no question, therefore, that Goldberg had access to client material related to the issues here. Likewise, there can be no question that

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[4] Ethical Consideration 4-4. See *Doe* v. *A Corp.*, 330 F. Supp. 1352, 1356 (S.D.N.Y. 1971), *aff'd per curiam*, 453 F.2d 1375 (2d Cir. 1972).

[5] *Emle Industries, Inc.* v. *Patentex, Inc.*, *supra*, 478 F.2d at 571; *Richardson* v. *Hamilton Int'l Corp.*, *supra*; *Empire Linotype School, Inc.* v. *United States*, 143 F. Supp. 627, 632 (S.D.N.Y. 1956); *T. C. Theatre Corp.* v. *Warner Bros. Pictures, Inc.*, 113 F. Supp. 265, 268, *motion to reargue denied*, 125 F. Supp. 233 (S.D.N.Y. 1953).

[6] *Emle Industries, Inc.* v. *Patentex, Inc.*, *supra*, 478 F.2d at 571.

he has associated with, and made disclosures to, the plaintiffs without the consent of Empire. The mere association compromises the confidences which Canon 4 seeks to protect. At the very least, when a former client is sued, he has a right to assume that his former attorneys will not voluntarily disclose what they know about the issues in litigation to the client's adversary or to his adversary's attorneys.[7] The fact that Goldberg no longer represented Empire, or even that plaintiffs had named him as a defendant, does not relieve him of his professional responsibility.[8]

Furthermore, association with the former client's adversary gives the appearance of impropriety. All other defendants were served; Goldberg, alone, among the named defendants was not served, and it was counsel for the plaintiffs who requested that Goldberg be dropped as a defendant. However innocent the association with the former client's adversary's counsel may have been, it clearly has the appearance of impropriety.

Counsel for the plaintiffs cannot disentangle themselves from the tainted association. They agreed to meet with Goldberg and were willing, if not eager, listeners to disclosures of confidences which they knew, or should have known, were protected by the Canons of Professional Responsibility. They, thus, not only encouraged but also participated in a violation of Canon 4 and Canon 9.

Plaintiffs argue, however, that the alleged omissions and misstatements by Empire constitute, if true, a continuing criminal and civil violation of the anti-fraud provisions of the securities laws and that, therefore, Goldberg was re-

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[7] Ethical Considerations 4-2 and 4-5.

[8] Ethical Consideration 4-6.

quired to reveal the information to the SEC by Disciplinary Rule 7-102(B)(1). That rule provides:

> "A lawyer who receives information clearly establishing that:
>
> (1) His client, has in the course of the representation, perpetrated a fraud upon a person or tribunal shall promptly call upon his client to rectify the same, and if his client refuses or is unable to do so, he shall reveal the fraud to the affected person or tribunal."

Goldberg disclosed the information to the SEC in January 1973, and in April of that year Empire disclosed the information in its annual report to stockholders which it filed with the SEC. The complaint here was thus filed on the basis of information already public. Disciplinary Rule 7-102(B)(1) requires the lawyer to reveal the fraud only if the client refuses to do so. Since the client had already revealed the omission to its stockholders and to the public, via the SEC, Goldberg had no further obligation under Disciplinary Rule 7-102(B)(1) to reveal the information or to discuss the matter with plaintiffs' counsel.[9]

Plaintiffs further argue that Goldberg's disclosures could have been compelled through the discovery process. The argument is both immaterial and premature. As we have shown, the issues raised here are broader than the attorney-client privilege and whether the disclosure of information will offend that privilege must await concrete situations during discovery or trial. Moreover, discovery is conducted within the supervision of the court. No such

[9] We do not consider the propriety of Goldberg's disclosures to the SEC.

safeguards were available at the meetings between plaintiffs' counsel and Goldberg.

Plaintiffs also raise other arguments based on the attorney-client privilege. They attempt to show that the attorney-client privilege does not apply and therefore that there was no bar to Goldberg's meeting with plaintiffs' counsel. These arguments are inapposite, since, as we have seen, we are concerned with the broader obligations of Canons 4 and 9. We hold only that, under the circumstances shown here, the meetings between Goldberg and counsel were violative of Canons 4 and 9. We need not and do not reach any situation which may later arise where the attorney-client privilege may be in issue.

We now consider the scope of the relief. The circumstances of this case have put all parties and counsel in an unusual situation. The questions presented are close. Both Goldberg and counsel consulted as to the propriety of their meetings and the disclosures, and we think they acted in good faith. However, in keeping with the "strict prophylactic rule" of *Emle Industries, Inc.* v. *Patentex, Inc.*, 478 F.2d 562 (2 Cir. 1973), to protect confidences and to ensure propriety and the appearance of propriety on the part of the bar, we must prevent such conduct as that shown here.

Accordingly, counsel for plaintiffs and Goldberg are enjoined and barred from acting as counsel or participating in any way with counsel for the plaintiffs in this action or in any future action against Empire involving the same transactions, occurrences, events, allegations, facts or issues, and they are further enjoined from disclosing confidential information regarding Empire to others except to comply with rulings of the court on discovery proceedings or upon trial. All other injunctive relief requested is denied.

The affidavits submitted to us *in camera*, specifically, Goldberg's affidavit of June 21, 1973 and Goldberg's affidavit of January 26, 1973 prepared for the SEC, shall be made a part of the record and sealed by the Clerk of the court.

In light of the foregoing, it becomes necessary to dismiss the complaint and this action without prejudice. Since we have dismissed the action, there is no need to consider plaintiffs' motion for an order determining this to be a class action.

So ordered.

Dated: New York, N. Y.
August 23, 1973

/s/ LLOYD F. MACMAHON
Lloyd F. MacMahon
United States District Judge

UNITED STATES COURT OF APPEALS

FOR THE SECOND CIRCUIT

Nos. 512-14—September Term, 1973.

(Argued January 16, 1974 Decided June 10, 1974.)

Docket Nos. 73-2340, 73-2443, 73-2501

DIETRICH MEYERHOFER and HERBERT FEDERMAN,

Appellants-Appellees,

BERNSON, HOENIGER, FREITAG & ABBEY,

Appellants,

STUART CHARLES GOLDBERG,

Intervenor-Appellant,

v.

EMPIRE FIRE AND MARINE INSURANCE COMPANY, GARY O. GROSS, YALE J. KAPLAN, ROBERT A. PHILLIPS, FRANCIS J. KRATKY, NICK LALICH, L. C. SWICK, M. M. JENNINGS, JR., SITOMER, SITOMER & PORGES, ALVIN L. SITOMER, STEPHAN J. SITOMER and ROBERT E. PORGES,

Appellees-Appellants,

FAULKNER, DAWKINS & SULLIVAN SECURITIES CORP.,

Defendant.

Before:

MOORE, FRIENDLY and ANDERSON,

Circuit Judges.

Appeal from a memorandum decision and order of the United States District Court for the Southern District of

New York, Hon. Lloyd F. MacMahon, *Judge,* (a) dismissing plaintiffs' action without prejudice, (b) enjoining and disqualifying plaintiffs' counsel and Stuart Charles Goldberg from acting as attorneys for plaintiffs in any action against the Empire Fire and Marine Insurance Company arising out of the same events, and (c) enjoining plaintiffs' counsel and Stuart Charles Goldberg from disclosing confidential information to others; also, cross-appeals seeking disqualification of plaintiffs.

Order reversed in part and affirmed in part; cross-appeals dismissed.

ROGERS M. DOERING, New York, N. Y. (Simpson, Thacher & Bartlett, New York, N. Y., and Cynthia M. Cohen, of counsel), *for appellants and cross-appellees Dietrich Meyerhofer, Herbert Federman and Bernson, Hoeniger, Freitag & Abbey.*

LAWRENCE M. MCKENNA, New York, N. Y. (Wormser, Kiely, Allesandroni, Mahoney & McCann, New York, N. Y., of counsel), *for intervenor-appellant Stuart Charles Goldberg.*

ANTHONY L. TERSIGNI, New York, N. Y. (Aranow, Brodsky, Bohlinger, Benetar, Einhorn & Dann, New York, N. Y., George Berlstein and Kathryn E. Zenoff, of counsel), *for appellees and cross-appellants Empire Fire and Marine Insurance Company, Gary O. Gross, Yale J. Kaplan, Robert A. Phillips, Francis J. Kratky, Nick Lalich, L. C. Swick and M. M. Jennings, Jr.*

ROBERT E. MESHEL, New York, N. Y. (D'Amato, Costello & Shea, New York, N. Y., George G. D'Amato, of counsel), *for appellees and cross-appellants Sitomer, Sitomer & Porges, Alvin L. Sitomer, Stephen J. Sitomer and Robert E. Porges.*

THE SECURITIES AND EXCHANGE COMMISSION, Washington, D.C. (Lawrence E. Nerheim, General Counsel, Theodore Sonde, Assistant General Counsel and Theodore L. Freedman, Attorney), *as amicus curiae.*

MOORE, *Circuit Judge:*

This is an appeal by Dietrich Meyerhofer and Herbert Federman, plaintiffs, and their counsel, Bernson, Hoeniger, Freitag & Abbey, from an order of the United States District Court for the Southern District of New York, dated August 23, 1973, (a) dismissing without prejudice plaintiffs' action against defendants, (b) enjoining and disqualifying plaintiffs' counsel, Bernson, Hoeniger, Freitag & Abbey, and Stuart Charles Goldberg from acting as attorneys for plaintiffs in this action or in any future action against defendant Empire Fire and Marine Insurance Company (Empire) involving the same transactions, occurrences, events, allegations, facts or issues, and (c) enjoining Bernson, Hoeniger, Freitag & Abbey and Stuart Charles Goldberg from disclosing confidential information regarding Empire to others. Intervenor Stuart Charles Goldberg also appeals from said order.

Defendants Empire, Gross, Kaplan, Phillips, Kratky, Lalich, Swick, Jennings, Jr., Sitomer, Sitomer & Porges, A. L. Sitomer, S. J. Sitomer and Robert E. Porges cross-appeal from the order insofar as that order failed to dis-

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qualify plaintiffs, Meyerhofer and Federman, from acting as class representatives of those who purchased the common stock of Empire, or to enjoin them from disclosing confidential information learned either from Bernson, Hoeniger, Freitag & Abbey or from Stuart Charles Goldberg.

The full import of the problems and issues presented on this appeal cannot be appreciated and analyzed without an initial statement of the facts out of which they arise.

Empire Fire and Marine Insurance Company on May 31, 1972, made a public offering of 500,000 shares of its stock, pursuant to a registration statement filed with the Securities and Exchange Commission (SEC) on March 28, 1972. The stock was offered at $16 a share. Empire's attorney on the issue was the firm of Sitomer, Sitomer & Porges. Stuart Charles Goldberg was an attorney in the firm and had done some work on the issue.

Plaintiff Meyerhofer, on or about January 11, 1973, purchased 100 shares of Empire stock at $17 a share. He alleges that as of June 5, 1973, the market price of his stock was only $7 a share—hence, he has sustained an unrealized loss of $1,000. Am'd Compl. ¶9a. Plaintiff Federman, on or about May 31, 1972, purchased 200 shares at $16 a share, 100 of which he sold for $1,363, sustaining a loss of some $237 on the stock sold and an unrealized loss of $900 on the stock retained.

On May 2, 1973, plaintiffs, represented by the firm of Bernson, Hoeniger, Freitag & Abbey (the Bernson firm), on behalf of themselves and all other purchasers of Empire common stock, brought this action alleging that the registration statement and the prospectus under which the Empire stock had been issued were materially false and misleading. Thereafter, an amended complaint, dated June 5, 1973, was served. The legal theories in both were iden-

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tical, namely, violations of various sections of the Securities Act of 1933, the Securities Exchange Act of 1934, Rule 10b-5, and common law negligence, fraud and deceit. Damages for all members of the class or rescission were alternatively sought.

The lawsuit was apparently inspired by a Form 10-K which Empire filed with the SEC on or about April 12, 1973. This Form revealed that "The Registration Statement under the Securities Act of 1933 with respect to the public offering of the 500,000 shares of Common Stock did not disclose the proposed $200,000 payment to the law firm as well as certain other features of the compensation arrangements between the Company [Empire] and such law firm [defendant Sitomer, Sitomer and Porges]." Later that month Empire disseminated to its shareholders a proxy statement and annual report making similar disclosures.

The defendants named were Empire, officers and directors of Empire, the Sitomer firm and its three partners, A. L. Sitomer, S. J. Sitomer and R. E. Porges, Faulkner, Dawkins & Sullivan Securities Corp., the managing underwriter, Stuart Charles Goldberg, originally alleged to have been a partner of the Sitomer firm, and certain selling stockholders of Empire shares.

On May 2, 1973, the complaint was served on the Sitomer defendants and Faulkner. No service was made on Goldberg who was then no longer associated with the Sitomer firm. However, he was advised by telephone that he had been made a defendant. Goldberg inquired of the Bernson firm as to the nature of the charges against him and was informed generally as to the substance of the complaint and in particular the lack of disclosure of the finder's fee arrangement. Thus informed, Goldberg requested an opportunity to prove his non-involvement in any such arrangement and his lack of knowledge thereof. At this

stage there was unfolded the series of events which ultimately resulted in the motion and order thereon now before us on appeal.

Goldberg, after his graduation from Law School in 1966, had rather specialized experience in the securities field and had published various books and treatises on related subjects. He became associated with the Sitomer firm in November 1971. While there Goldberg worked on phases of various registration statements including Empire, although another associate was responsible for the Empire registration statement and prospectus. However, Goldberg expressed concern over what he regarded as excessive fees, the nondisclosure or inadequate disclosure thereof, and the extent to which they might include a "finder's fee," both as to Empire and other issues.

The Empire registration became effective on May 31, 1972. The excessive fee question had not been put to rest in Goldberg's mind because in middle January 1973 it arose in connection with another registration (referred to as "Glacier"). Goldberg had worked on Glacier. Little purpose will be served by detailing the events during the critical period January 18 to 22, 1973, in which Goldberg and the Sitomer partners were debating the fee disclosure problem. In summary, Goldberg insisted on a full and complete disclosure of fees in the Empire and Glacier offerings. The Sitomer partners apparently disagreed and Goldberg resigned from the firm on January 22, 1973.

On January 22, 1973, Goldberg appeared before the SEC and placed before it information subsequently embodied in his affidavit dated January 26, 1973, which becomes crucial to the issues now to be considered.

Some three months later, upon being informed that he was to be included as a defendant in the impending action, Goldberg asked the Bernson firm for an opportunity to demonstrate that he had been unaware of the finder's

fee arrangement which, he said, Empire and the Sitomer firm had concealed from him all along. Goldberg met with members of the Bernson firm on at least two occasions. After consulting his own attorney, as well as William P. Sullivan, Special Counsel with the Securities and Exchange Commission, Division of Enforcement, Goldberg gave plaintiffs' counsel a copy of the January 26th affidavit which he had authored more than three months earlier. He hoped that it would verify his nonparticipation in the finder's fee omission and convince the Bernson firm that he should not be a defendant. The Bernson firm was satisfied with Goldberg's explanations and, upon their motion, granted by the court, he was dropped as a defendant. After receiving Goldberg's affidavit, the Bernson firm amended plaintiffs' complaint. The amendments added more specific facts but did not change the theory or substance of the original complaint.

By motion dated June 7, 1973, the remaining defendants moved "pursuant to Canons 4 and 9 of the Code of Professional Responsibility, the Disciplinary Rules and Ethical Considerations applicable thereto, and the supervisory power of this Court" for the order of disqualification now on appeal.

By memorandum decision and order, the District Court ordered that the Bernson firm and Goldberg be barred from acting as counsel or participating with counsel for plaintiffs in this or any future action against Empire involving the transactions placed in issue in this lawsuit and from disclosing confidential information to others.

The complaint was dismissed without prejudice. The basis for the Court's decision is the premise that Goldberg had obtained confidential information from his client Empire which, in breach of relevant ethical canons, he revealed to plaintiffs' attorneys in their suit against Empire. The

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Court said its decision was compelled by "the broader obligations of Canons 4 and 9." [1]

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1 Code of Professional Responsibility

Canon 4

A Lawyer Should Preserve the Confidence and Secrets of a Client

Ethical Considerations

EC 4-1 Both the fiduciary relationship existing between lawyer and client and the proper functioning of the legal system require the preservation by the lawyer of confidences and secrets of one who has employed or sought to employ him.

* * * *

EC 4-4 The attorney-client privilege is more limited than the ethical obligation of a lawyer to guard the confidences and secrets of his client. The ethical precept, unlike the evidentiary privilege, exists without regard to the nature or source of information or the fact that others share the knowledge. A lawyer should endeavor to act in a manner which preserves the evidentiary privilege . . . .

EC 4-5 A lawyer should not use information acquired in the course of the representation of a client to the disadvantage of the client and a lawyer should not use, except with the consent of his client after full disclosure, such information for his own purposes . . . .

EC 4-6 The obligation of a lawyer to preserve the confidences and secrets of his client continues after the termination of his employment . . . .

Disciplinary Rules

DR 4-101 Preservation of Confidences and Secrets of a Client.

(A) "Confidence" refers to information protected by the attorney-client privilege under applicable law, and "secret" refers to other information gained in the professional relationship that the client has requested be held inviolate or the disclosure of which would be embarrassing or would be likely to be detrimental to the client.

(B) Except when permitted under DR 4-101(C), a lawyer shall not knowingly:

(1) Reveal a confidence or secret of his client.

(2) Use a confidence or secret of his client to the disadvantage of the client.

(3) Use a confidence or secret of his client for the advantage of himself or of a third person, unless the client consents after full disclosure.

(C) A lawyer may reveal:

(4) Confidences or secrets necessary to establish or collect his fee or to defend himself or his employees or associates against an accusation of wrongful conduct.

There is no proof—not even a suggestion—that Goldberg had revealed any information, confidential or otherwise, that might have caused the instigation of the suit. To the contrary, it was not until after the suit was commenced that Goldberg learned that he was in jeopardy. The District Court recognized that the complaint had been based on Empire's—not Goldberg's—disclosures, but concluded because of this that Goldberg was under no further obligation "to reveal the information or to discuss the matter with plaintiffs' counsel."

Despite the breadth of paragraphs EC4-4 and DR4-101 (B), DR4-101 (C) recognizes that a lawyer may reveal confidences or secrets necessary to defend himself against "an accusation of wrongful conduct." This is exactly what Goldberg had to face when, in their original complaint, plaintiffs named him as a defendant who wilfully violated the securities laws.

The charge, of knowing participation in the filing of a false and misleading registration statement, was a serious one. The complaint alleged violation of criminal statutes

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Canon 9

A Lawyer Should Avoid Even the Appearance of Professional Impropriety

Ethical Considerations

EC 9-1 Continuation of the American concept that we are to be governed by rules of law requires that the people have faith that justice can be obtained through our legal system. A lawyer should promote public confidence in our system and in the legal profession.

EC 9-6 Every lawyer owes a solemn duty to uphold the integrity and honor of his profession: to encourage respect for the law and for the courts and the judges thereof; to observe the Code of Professional Responsibility; to act as a member of a learned profession, one dedicated to public service; to cooperate with his brother lawyers in supporting the organized bar through the devoting of his time, efforts, and financial support as his professional standing and ability reasonably permit; to conduct himself so as to reflect credit on the legal profession and to inspire the confidence, respect, and trust of his clients and of the public; and to strive to avoid not only professional impropriety but also the appearance of impropriety.

and civil liability computable at over four million dollars. The cost in money of simply defending such an action might be very substantial. The damage to his professional reputation which might be occasioned by the mere pendency of such a charge was an even greater cause for concern.

Under these circumstances Goldberg had the right to make an appropriate disclosure with respect to his role in the public offering. Concomitantly, he had the right to support his version of the facts with suitable evidence.

The problem arises from the fact that the method Goldberg used to accomplish this was to deliver to Mr. Abbey, a member of the Bernson firm, the thirty page affidavit, accompanied by sixteen exhibits, which he had submitted to the SEC. This document not only went into extensive detail concerning Goldberg's efforts to cause the Sitomer firm to rectify the nondisclosure with respect to Empire but even more extensive detail concerning how these efforts had been precipitated by counsel for the underwriters having come upon evidence showing that a similar nondisclosure was contemplated with respect to Glacier and their insistence that full corrective measures should be taken. Although Goldberg's description reflected seriously on his employer, the Sitomer firm and, also, in at least some degree, on Glacier, he was clearly in a situation of some urgency. Moreover, before he turned over the affidavit, he consulted both his own attorney and a distinguished practitioner of securities law, and he and Abbey made a joint telephone call to Mr. Sullivan of the SEC. Moreover, it is not clear that, in the context of this case, Canon 4 applies to anything except information gained from Empire. Finally, because of Goldberg's apparent intimacy with the offering, the most effective way for him to substantiate his story was for him to disclose the SEC affidavit. It was the fact that he had written such an affidavit at an

earlier date which demonstrated that his story was not simply fabricated in response to plaintiffs' complaint.

The District Court held: "All that need be shown . . . is that during the attorney-client relationship Goldberg had access to his client's information relevant to the issues here." *See Emle Industries, Inc.* v. *Patentex, Inc.*, 478 F.2d 562 (2d Cir. 1973). However, the irrebuttable presumption of *Emle Industries* has no application to the instant circumstances because Goldberg never sought to "prosecute litigation," either as a party, *compare Richardson* v. *Hamilton International Corp.*, 42 U.S.L.W. 2519 (E.D.Pa. Mar. 8, 1974), or as counsel for a plaintiff party. *Compare T.C. Theatre Corporation* v. *Warner Brothers Pictures*, 113 F.Supp. 265 (S.D.N.Y. 1953). At most the record discloses that Goldberg might be called as a witness for the plaintiffs but that role does not invest him with the intimacy with the prosecution of the litigation which must exist for the *Emle* presumption to attach.

In addition to finding that Goldberg had violated Canon 4, the District Court found that the relationship between Goldberg and the Bernson firm violated Canon 9 of the Code of Professional Responsibility which provides that:

> EC 9-6 Every lawyer [must] strive to avoid not only professional impropriety but also the appearance of impropriety.

The District Court reasoned that even though there was no evidence of bad faith on the part of either Goldberg or the Bernson firm, a shallow reading of the facts might lead a casual observer to conclude that there was an aura of complicity about their relationship. However, this provision should not be read so broadly as to eviscerate the right of self-defense conferred by DR4-101 (C)(4).

Nevertheless, *Emle Industries, Inc.* v. *Patentex, Inc., supra,* requires that a strict prophylactic rule be applied in these cases to ensure that a lawyer avoids representation of a party in a suit against a former client where there may be the appearance of a possible violation of confidence. To the extent that the District Court's order prohibits Goldberg from *representing* the interests of these or any other plaintiffs in this or similar actions, we affirm that order. We also affirm so much of the District Court's order as enjoins Goldberg from disclosing material information except on discovery or at trial.

The burden of the District Court's order did not fall most harshly on Goldberg; rather its greatest impact has been felt by Bernson, Hoeniger, Freitag & Abbey, plaintiffs' counsel, which was disqualified from participation in the case. The District Court based its holding, not on the fact that the Bernson firm showed bad faith when it received Goldberg's affidavit, but rather on the fact that it was involved in a tainted association with Goldberg because his disclosures to them inadvertently violated Canons 4 and 9 of the Code of Professional Responsibility. Because there are no violations of either of these Canons in this case, we can find no basis to hold that the relationship between Goldberg and the Bernson firm was tainted. The District Court was apparently unpersuaded by appellees' salvo of innuendo to the effect that Goldberg "struck a deal" with the Bernson firm or tried to do more than prove his innocence to them. Since its relationship with Goldberg was not tainted by violations of the Code of Professional Responsibility, there appears to be no warrant for its disqualification from participation in either this or similar actions. *A fortiori* there was no sound basis for disqualifying plaintiffs or dismissing the complaint.

Order dismissing action without prejudice and enjoining Bernson, Hoeniger, Freitag & Abbey from acting as coun-

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sel for plaintiffs herein reversed. Upon cross-appeal by Empire, Gross, Kaplan, Phillips, Kratky, Lalich, Swick and Jennings, Jr., and cross-appeal by Sitomer, Sitomer and Porges, A. L. Sitomer, S. J. Sitomer and R. E. Porges insofar as said orders failed to enjoin plaintiffs from disclosing confidential information regarding Empire and to disqualify plaintiffs from representing themselves or a similar class of Empire stockholders, appeals dismissed. To the extent that the orders appealed from prohibit Goldberg from acting as a party or as an attorney for a party in any action arising out of the facts herein alleged, or from disclosing material information except on discovery or at trial, they are affirmed.

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